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SUBJECT: FUTURE OF NIGERIAN OIL & GAS

1. Cable is sensitive but unclassified. Please protect accordingly.

2.(SBU) Summary: On July 11 and 12, Econoffs met with a variety of oil producing and servicing companies to gain insight into the current state of the Nigerian oil and gas industry and assess the country's potential contribution to world oil supply over the next ten years. Companies expressed very positive views on future exploration and production opportunities, highlighting their new investments in deep water and natural gas projects. Oil companies unanimously agreed they could meet the GON's ambitious target of 40 billion barrels of reserves and 4 million barrels/day of production by 2010. While all believe Nigeria has the capacity to contribute a larger share of world supply, actual production will depend on OPEC quota restraints and the country's ability to attract investment. End Summary.

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Companies Look to DeepWater  
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.(SBU) In a series of meetings with ChevronTexaco, Conoco, ExxonMobil, Shell, and Halliburton representatives, Econoffs received a detailed view of the Nigerian oil and gas sector, especially the companies' plans to seriously increase production. In order to speak more freely, the representatives asked that they not be identified directly. Most of the increase in production will come from deep water blocks, which are areas with water depths between 500-1500 meters. All companies expressed great enthusiasm over the future production possibilities of these blocks. Wells drilled from the first round of deep water licenses, awarded in 1993, are scheduled to begin producing next year. The first of those fields, Shell's Bonga, could produce as much as 225,000 b/d at full operation. The government recently completed agreements from the 2000 round of deep water licenses. Companies believe deep water exploration in Nigeria has only just begun. With more exploration and advances in technology, many more substantial discoveries could be made.

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The Future of Gas  
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4.(SBU) Encouraged by the government's ban on routine flaring by 2008, investment in the gas sector is on the rise. Although the Nigerian economy is heavily dependent on oil today, gas could be the future. According to a government study published last year, Nigeria has an estimated 182 trillion standard cubic feet (tcf) of recoverable gas reserves. However, sources say the country could possess as much as 300 tcf. Currently the ninth largest source, some companies believe Nigeria could become the second or third largest producer as the industry develops and world demand for cleaner fuel increases. Currently, most of the gas will be exported to the European and American markets. Companies also expect to supply gas to the West African Gas Pipeline once it is brought online.

5.(SBU) One potential short-term impediment to gas development is the absence of gas provisions in the Production Sharing Contracts (PSC), the contracts that govern the deep water projects. At the moment, the contracts make no provision for who owns or has the right to develop the gas. The government and the companies will have to negotiate a solution. Failure to reach a timely compromise could hamper future operations.

6.(SBU) In the future, many believe that Nigeria, given the right conditions, could develop a very successful gas industry. To encourage the process, oil companies suggest that the Nigerian government develop a national energy plan, including policies aimed at increasing domestic gas utilization. Companies cited deregulation of the gas market, specifically market driven pricing, as a prerequisite to a

successful market. Companies would also like the government to create fiscal incentives for private investment in the sector.

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OPEC : Feeling the cut  
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7.(SBU) While capacity building investment continues, this year's OPEC cutbacks have not gone unnoticed in Nigeria. Even indigenous oil firms have been affected, unlike previous years when multi-national companies took most of the hit. During the cutbacks, companies are focusing on capacity building rather than production. With billions of dollars being pumped into deepwater and gas projects companies could be, as one company representative stated, "on a collision course with OPEC" if the quota levels remain unchanged.

8.(SBU) The question of where OPEC quotas will be allocated in the future is on the minds of all companies. Some fear that the government will first allocate production to joint venture projects, not the deep water PSC blocks, because of the instant revenue benefit. Under the joint venture arrangement, the government gets a share of oil revenue immediately unlike PSCs where the oil companies recover costs over time before sharing a portion of the profits. Substantial production cutbacks could have a very negative impact on the oil companies' large and time sensitive deep water investments.

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Impact of Community Issues on Production and Investment  
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9.(SBU) While investment in deep water and gas projects continues at full speed, companies continue to wrestle with the challenges that come with operating in Nigeria. One of the most significant issues is community relations. Even though the companies all expressed concern over the daily impact of community disturbances on operations, they all believed the problems were manageable and would not significantly impact production levels over time. But even figuring in community interruptions to production (one company figured 40 percent of total capacity could be offline at any time), Nigeria's production future still looks robust.

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The NNPC as a Business Partner  
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10.(SBU) In addition to community issues, many representatives expressed frustration in their business dealings with the NNPC. Even beginning a business venture with the government can be difficult. One problem expressed was "contract erosion," meaning that the NNPC has a tendency to change the rules of the game after contracts were signed. Lack of transparency in awarding energy sector contracts was also cited as a serious problem.

11.(SBU) Once ventures begin, general bureaucratic delays over the course of a project have a significant impact. To go from winning the license to beginning production can be a long and frustrating process. Due to bureaucratic impediments, the first deep water wells will take 10 years to begin operations, an unusually long period of time according to company representatives.

12.(SBU) As for future relations, one company representative stated that the government does not have enough money to continue all planned projects. This uncertainty creates a difficult investment climate. As of April 2002, the NNPC was \$1.78 billion behind on its joint venture cash calls, the government's contribution to costs. However, he stated that the private sector possesses the capital and the appetite to increase its share of investment. Companies encouraged efforts by the USG to support a more stable investment climate in Nigeria.

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Comment  
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13.(SBU)Comment: All the oil companies we spoke with gave the picture of a very robust and expanding Nigerian energy

sector. Despite the obstacles, companies appear undeterred by potential hurdles such as OPEC quotas, security problems in the Delta, and frustrating relations with the government. While investments in capacity building are in full swing, Nigeria's share of OPEC quotas seems too small given the level of current investment and the government's own targets for production. If Nigeria's quota share does not increase, companies could face difficulties recovering the cost of their current investments.

14.(SBU) Nigeria remains a committed member of OPEC, giving every indication they plan to remain within the OPEC fold. Rilwani Lukman, Obasanjo's oil advisor and current OPEC President, recently said that Nigeria would like to increase production but only if the move will not depress prices. It remains to be seen what the government will do if the increase in Nigeria's production capacity does not translate into a greater share of OPEC quotas. In all likelihood, Nigeria will remain with OPEC and fight for a larger quota share. However, in the past Nigeria has frequently produced above its quota and could certainly do so again in the future. End Comment.  
HINSON-JONES